

Service Date: August 17, 1989

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application)	
of the BUTTE WATER COMPANY for)	UTILITY DIVISION
Authority to Increase Rates and)	DOCKET NO. 88.9.29
Charges for Water Service to its)	ORDER NO. 5382b
Butte, Montana Customers.)	

APPEARANCES

FOR THE APPLICANT:

James Robischon, Attorney at Law, Murphy, Robinson,
Heckathorn & Phillips P.O. Box 759, Kalispell,
Montana 59903.

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34
West 6th Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Denise Peterson, Staff Attorney, 2701 Prospect Avenue,
Helena, Montana 59620.

Ron Woods, Rate Analyst, 2701 Prospect Avenue, Helena,
Montana.

BEFORE:

JOHN DRISCOLL, Commissioner & Hearing Examiner
CLYDE JARVIS, Chairman
HOWARD ELLIS, Commissioner
DANNY OBERG, Commissioner

BACKGROUND

1. On September 26, 1988, Butte Water Company (Applicant or BWC) filed an application with this Commission for authority to increase water rates and charges to its Butte, Montana customers on a permanent basis by approximately 18.4%. This constitutes an annual revenue increase of approximately \$685,356 (See Exhibit E, Schedule DC-1).

2. Concurrent with its filing for a permanent increase in rates, BWC filed an application for an interim increase in rates. BWC's requested interim rate increase would have increased annual revenues by approximately \$489,484.

3. On November 21, 1988, after proper notice, a hearing was held in the City Council Chambers, Butte, Montana. For the convenience of the consuming public there was also a night session that commenced at 7:00 p.m. on November 21, 1988, at the same location. The public hearing was bifurcated to consider the merits of the Applicant's proposed water rate adjustment and to consider the adequacy of service provided to water subscribers in BWC's Butte, Montana service area.

4. On December 2, 1988, the Commission, having considered the testimony and supporting exhibits submitted at the public hearing in support of the Applicant's interim application, issued Order No.

5382 granting the Applicant interim relief in the amount of \$460,166.

5. On March 16, 1989, after completion of its responses to data requests and meetings with the staff of the MCC and the Commission BWC filed revised interim tariff tables for its Butte Division incorporating a reduction of flat rate charges, other than sprinkling, of 8.23% from the interim rates authorized in Order 5382. The proposed reduction in rates represented an annual revenue reduction in the amount of \$138,913. BWC filed the revised tariffs because it had determined that it could not support an annual revenue increase of the magnitude authorized in the original interim order. (BWC letter of application, March 16, 1989.)

6. On March 27, 1989, the Commission, after reviewing BWC's proposal to reduce interim rates, issued Order No. 5382a. This Order provided that BWC was authorized to decrease rates by the 8.23% requested. The order also provided that BWC would, over a four month period, return to the ratepayers \$38,601 in overcollected revenues.

7. On April 18, 1989, after proper notice, an additional hearing was held in the City Council Chambers, Butte, Montana. For the convenience of the consuming public a night session was held commencing at 7:00 p.m. at the same location. The purpose of this public hearing was to receive additional testimony so that the Commission could make a final determination regarding the application for increased rates.

FINDINGS OF FACT

8. During the public hearings on the Applicant's proposed rate adjustment and on adequacy of service, the Applicant presented the testimony and exhibits of:

James Chelini, President & General Manager, BWC
Mike Patterson, Vice President & Operations Manager, BWC
Don Cox, Certified Public Accountant

9. At the public hearings the Montana Consumer Counsel (MCC) presented the testimony and exhibits of one expert witness, Frank Buckley, Rate Analyst, Montana Consumer Counsel, and four public witnesses.

10. By the time of the hearing in April the MCC and BWC had resolved to their satisfaction all issues concerning the revenue requirement calculation in this Docket, except one. The issue still in dispute between these two parties was the matter of interest synchronization. Interest synchronization is a ratemaking procedure used in many regulatory jurisdictions to compute tax deductible interest expense when a hypothetical capital structure is used to establish a reasonable rate of return. BWC in this application proposed the use of a hypothetical capital structure (50% debt - 50% equity), therefore, the MCC through its expert witness proposed the use of interest synchronization in calculating BWC's overall revenue requirement. BWC objected to the MCC's

proposed interest synchronization adjustment on the grounds that it would represent the imputation of a fictitious capital interest expense to the company's income tax expense when none actually existed.

11. In this Order there is no need for the Commission to address and resolve the last remaining contested issue between the parties because the testimony received in this Docket clearly reveals that BWC is not discharging two of its primary public utility obligations. As a public utility BWC is required to satisfy a three part equation in the discharge of its public utility obligation. The components of this three part equation are reasonably adequate service plus reasonably adequate facilities plus just and reasonable rates equals discharge of public utility obligation (Section 69-3-201, MCA). BWC is not providing its customers with reasonably adequate service and facilities; BWC's failure to discharge these relevant regulatory requirements impact the Commission's revenue need deliberations.

12. The Commission in discharging its regulatory duties has an obligation to establish rates and charges that are just and reasonable for both the utility and its ratepayers. This obligation requires that the Commission, in assessing the reasonableness

of proposed rates, must balance the concerns of the Company and the ratepayer. The utility's concern is in making a just and reasonable rate of return on its investment. The consumer's concern is in receiving reasonably adequate service and facilities at just and reasonable rates.

13. The Commission in this Docket's Order No. 5387 addresses the provision of reasonably adequate service and facilities by BWC in its Butte Division and determined both to be inadequate. It is necessary in this Order to examine the relationship between the provision of inadequate service and facilities by BWC and the revenue needs of BWC. The issue that must ultimately be resolved by the Commission in this Order is whether or not BWC's proposed increase in rates and charges would represent the implementation of just and reasonable rates.

14. BWC as a regulated public utility is entitled to recover all reasonably incurred expenses and to earn a fair return on its investment. Subscribers to BWC's utility service are, therefore, obligated to pay rates and charges that will allow BWC the opportunity to recover its reasonable costs of service, including a fair return on investment.

15. BWC by making application for increased water rates and charges is claiming that it can demonstrate that the rates and charges in effect prior to filing of a rate increase application have become unjust and unreasonable. A utility makes a rate increase application on the presumption that it can establish, with reliable credible evidence, that current rates will not afford the utility the opportunity to recover its reasonable costs of providing service and/or the ability to earn a fair return on its investment. With the filing of a request for increased rates the Commission has the obligation to examine all matters pertaining to the utility operation that may impact its determination of need for rate relief. The Commission examines these matters because of its double regulatory duty to balance the interests of the company and the ratepayer in establishing reasonable rates.

16. The record in this Docket is replete with testimony and documentation that reveals BWC's operation and maintenance expenses to be significantly above a reasonable economic level. The testimony indicates that because of the physical condition of its existing utility plant BWC must expend large sums of monies on facility repair and maintenance just to continue to provide the current level of inadequate service being received by its

customers. To provide just one example of testimony that supports the above statements, Mr. Chelini testified as follows regarding BWC's distribution system:

The distribution lines in the major portion of the city are in extremely poor condition. We repair over 500 leaks in our distribution system per year, which is more than all five (5) of the other major cities in Montana combined. Our ability to obtain insurance is threatened, and our costs will continue to increase. (Prefiled direct testimony, page 7)

Q. In your prefiled testimony, you indicate that there's approximately 500 leaks experienced in your distribution system. That is more than all five of the other major cities in Montana combined. In your opinion, would it be reasonable to assume that the number of leaks on your distribution system should be approximately equal to that experienced in any one of the other major water systems individually as opposed to collectively?

A. Would you state that again, please?

Q. Well, in your opinion, should the number of leaks in the distribution system be equal to any one of the other cities in Montana that are referred to individually instead of collectively? In other words --

A. We shouldn't have any more leaks if we had an adequate system than other cities of comparable size. (Tr. page 23, November hearing.)

17. The previously quoted testimony of Mr. Chelini can be paraphrased as representing, that on average, the other 5 major water utilities are experiencing approximately 100 leaks or less per year on their distribution system and that he would not expect to have leaks in excess of that amount, if the BWC system were adequate. This being the case, by his own admission, Mr. Chelini reveals that if the Commission were to approve a rate increase the subscribers to the BWC's utility service would be burdened with the costs of repairing approximately 400 distribution system leaks that are attributable to the deteriorated condition of the utility plant.

18. The distribution system leak repair example clearly shows the uneconomic nature of expenses being incurred by BWC. A similar analysis can be done and the same conclusion drawn for other components of BWC's plant in service. BWC by requesting this increase wishes recovery, from subscribers, of uneconomically incurred expenses attributable to its inadequate facilities.

19. Repair and maintenance expenditures such as those described in the previous findings regarding the distribution that do not result in improved service to the consumer or an overall positive

effect improving the integrity of the facilities, in the Commission's view, cannot be characterized as a reasonable economic incurrence of expense. BWC personnel have testified that many components of the utility plant in service have reached the end of their economic useful life and need to be replaced or abandoned.

The facilities that need to be replaced or abandoned are in large part responsible for BWC's inability to provide reasonably adequate service. Absent replacement or abandonment of these facilities consumers cannot expect any improvement in the service provided by BWC. Further, the facilities that are at the end of their economic useful life, which presently require continual maintenance, will, if not replaced, continue to deteriorate, necessitating more and more maintenance, precipitating further increased costs of service, for which BWC would presumably request compensation.

20. The Commission finds that authorizing any increase at this time would provide a subsidy to BWC by allowing recovery through rates of operation and maintenance expenses that exceed a level that could reasonably be expected if the facilities were adequate.

Further, if the Commission were to authorize an increase to allow recovery of ever escalating operation and maintenance expenses that are controllable by the utility, there would be no economic

incentive for BWC, or any other regulated utility, to take appropriate action to rectify system deficiencies. The Commission further finds that it would not be just and reasonable for the ratepayer to reward BWC for inadequate service and facilities and that the rate allowed should reflect the inadequacies inherent in BWC's Butte service area. The Commission finds that the record warrants the denial of an increase in rates.

21. The Commission in BWC, Docket No. 86.3.7, Order No. 5194a made the following finding of fact:

When consumers are receiving inadequate service and encountering service problems, such as those outlined in this section, it is within the Commission's power to authorize reduced rates for those consumers receiving inadequate service. Since the Applicant represented that it is aware of the problems and examining possible improvements to the system to rectify the problems, the Commission will not in this Docket exercise its authority to implement reduced rates. But the Commission would caution the Applicant that if consumers continue to experience inadequate service, it will consider exercising its authority and order the implementation of reduced rates. (Finding of Fact No. 122)

Order No. 5194a was issued by the Commission October 3, 1986.

22. The Commission issued an order regarding the inadequacy of service and facilities currently provided by BWC to its Butte,

Montana customers (Order No. 5387, issued December 21, 1988). The service order supports a finding that it is not just and reasonable to grant an increase in rates for the inadequate service and facilities. A Commission finding that no increase is warranted should come as no surprise to BWC. The Commission gave BWC a clear warning over two (2) years ago that if service continued to be substandard the Commission would consider implementing reduced rates. At this time, however, the Commission will not order a reduction in the rates of BWC below the level that was in effect prior to December, 1988.

23. A Commission decision to deny BWC's request for increased rates in this proceeding due to inadequate service or facilities is consistent with previous Commission decisions. The Commission has previously exercised its authority to deny increases in rates, or ordered the implementation of reduced rates, in cases involving BWC (Docket No. 6801, Order No. 4699a; Docket No. 81.3.25, Order No. 4801a; Docket No. 82.3.13, Order No. 4896a) and Western Water Company (Docket No. 82.4.24, Order No. 4911a). In these Dockets the denial of a request for increased rates extended to those customers receiving inadequate service due to system deficiencies.

In this Docket the condition of the existing facilities affects

the service received by all subscribers connected to the system, and therefore it is appropriate to deny the entire increase requested by the Applicant.

24. The problem of a utility providing inadequate service is not a new one. Commissions in other jurisdictions have addressed the issue and when faced with a utility's failure to provide adequate service, Commissions have declined to increase rates. See e.g. Re Middle States Utilities Co. of Missouri (1947) 1 Mo PSC NS 1.c. 122, 72 PUR NS 17, 27; Re North Missouri Telephone Co., Inc., 49 PUR 3d 313, 318 (Mo. PSC 1963); Re General Telephone Co. of the Southwest, 89 PUR 3d 92 (Ark. PSC 1971); Re Citizens Utilities Co., 35 PUR 4th 378 (Idaho PUC 1980); Pennsylvania Public Service Commission, Docket No. R-850178.

25. The Commission finds based upon the preceding Findings of Fact that BWC's request for authorization to increase rates and charges in its Butte, Montana service area should be denied. The Commission further finds that all monies collected from consumers under interim rate approval should be refunded with interest.

CONCLUSIONS OF LAW

1. The Applicant, Butte Water Company, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates and service pursuant to 69-3-102, MCA.

2. The Commission has provided adequate notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this Order are just and reasonable. Section 69-3-201, and 69-3-330, MCA.

4. The Commission authorized interim rate relief in this Docket Order Nos. 5382 and 5382a. All monies collected under interim rates shall be rebated to consumers pursuant to the provisions of Section 69-3-304, MCA.

ORDER

NOW, THEREFORE, IT IS ORDERED THAT:

1. Butte Water Company's request for authorization to increase rates and charges in its Butte Division is hereby DENIED. Butte Water Company shall reinstitute rate schedules that were in effect prior to November 29, 1988.

2. Butte Water Company shall rebate all monies collected from consumers under interim rate approval in this Docket. The customer rebate calculation will include interest at the rate of 13.0% annually.

3. The rates approved herein shall become effective as of the date of this Order.

4. Butte Water Company shall file with the Commission its calculation of the monies to be rebated to consumers. In conjunction with the filing of this calculation Butte Water Company shall also file a proposed rebate schedule for Commission approval.

Customer rebates will commence with the first billing cycle after Commission acceptance of Butte Water Company's rebate calculation and approval of the rebate schedule.

DONE IN OPEN SESSION at Helena, Montana this 17th day of August, 1989 by a 4 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

DANNY OBERG, Commissioner

JOHN B. DRISCOLL, Commissioner

ATTEST:

Ann Purcell
Acting Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.